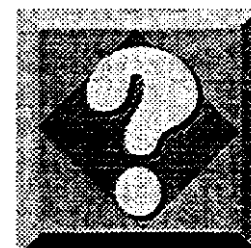


7

Economic Development Conveyances

Frequently Asked Questions About Economic Development Conveyances

➤ <i>What is an Economic Development Conveyance (EDC)?</i>	Section 7.1
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7.1 INTRODUCTION

7.1.1 A new authority: an additional tool for communities

Following the July 1993 announcement of the President's program to revitalize base closure communities, Congress created a new property conveyance authority, designed specifically to ease the economic hardship caused by base closures. Section 2903 of Title XXIX gives the Department of Defense the authority to transfer property to Local Redevelopment Authorities, for consideration at or below estimated fair market value, to spur economic redevelopment and job creation. This tool is referred to as the "Economic Development Conveyance."

7.1.2 Philosophy behind an EDC—Keys to success

Property at a closing military installation can be a valuable resource to a community's future economic development. While some bases in their current condition represent a valuable and marketable asset today, many bases will require substantial infrastructure investment to be reused in the private real estate market. With appropriate investment of time and money, they can become a valuable asset. The EDC was created to facilitate property transfer for community economic recovery while obtaining fair-and reasonable compensation for the Federal Government.

Economic Development Conveyances GUIDING PRINCIPLES FOR THE MILITARY DEPARTMENTS

- Job creation and rapid property transfers are the main goals.
- Work with the community to reach these common goals.
- Remember that quicker property transfers will benefit the Government through savings of protection and maintenance expenses. Waiting for the highest theoretical price for property may result in lower present value, or nothing at all.
- **Focus** on reaching agreement on realistic market trends. Due to the wide range of conditions existing in affected communities, appropriate market trends could result in estimates of fair market value ranging from zero to hundreds of millions of dollars.
- Encourage the community to take as much property as can be justified as part of an EDC. The EDC parcel should include a variety of properties, some of which may not be of immediate value without improvement, and some of which must be used to leverage financing for needed improvements.
- Look at community investment and risk. The more the community is investing in the overall development, the more they are contributing to the overall value. The less the community is investing, the higher the risk for the Federal Government and the more the Government is contributing to the overall value.
- Look at the financial resources of the EDC applicant. Be wary of undercapitalized entities, because without proper capital, the development may not be able to support the necessary investments to create and maintain job generation.
- Remember that the EDC is a new tool, specifically designed to allow for flexibility. There is no single way to structure an EDC or a cookie-cutter answer that applies in all cases. Keep in mind you are not bound by typical GSA rules for valuation or payment terms and conditions. This new authority *should* be used in creative and innovative ways!

7.1.3 Definition of an EDC

What is an EDC?

An EDC was created as a new method for transferring real property to an LRA to help spur local economic development and job creation. An EDC may be with or without initial payment at time of transfer and may be at or below the estimated fair market value of the property. Terms and conditions of payment to the Department of Defense are fully negotiable. These negotiations should be fair and reasonable to both parties and strike a balance between compensation to the Federal taxpayer and the need for the EDC to spur redevelopment and job creation.

When should an EDC be used?

7.1.4 Appropriate uses of an EDC

The EDC should be used when an LRA wants to obtain property for job-generating purposes, and the uses proposed by the LRA's redevelopment plan cannot be accomplished under the other Federal property transfer authorities. While the primary use of the EDC must be for long-term job creation and

economic redevelopment, the inclusion of other properties that facilitate this goal (e.g., housing for factory workers) may be acceptable.

Other such Federal property transfer authorities include the Federal Property and Administrative Services Act (FPASA) of 1949 (40 U.S.C. § 471 *et seq.*) and public airport conveyance authorities (49 U.S.C. §§ 47151-47153) that allow for transfers of property to units of government or non-profit institutions that maintain the use of property for various public purposes including, but not limited to, parks, public health, education, aviation, historic monuments, and prisons. DoD will not supplant these existing public benefit transfer authorities with EDCS and will work to ensure transfers of property under public benefit transfers are in accordance with the sponsoring Federal Agency regulations. The FPASA also allows for negotiated sales at fair market value to eligible public entities for public purposes or direct sales through a public bid process. (See Federal Property Management Regulations and sponsoring Agency regulations in Appendix E.)

Utility distribution systems and transportation networks form an integral part of infrastructure, which will often serve new development in the creation of jobs. Where other disposal authorities are not appropriate, these systems may be considered for inclusion in an EDC application.

7.1.5 Eligible EDC recipients

An LRA officially recognized by the Secretary of Defense through OEA is the **only** entity eligible to receive property under an EDC. The LRA may be a State or local government or an authority or instrumentality established by a State or local government that is responsible for directing implementation of the redevelopment plan. It should have broad-based membership, including, but not limited to, representatives from those jurisdictions with zoning authority over the property. Consequently, applications submitted by entities other than LRAs will not be considered.

|| **Who is eligible to apply for an EDC?**

7.2 APPLICATION PROCEDURES

An application must be prepared by the LRA as its formal request for property and to assist the Military Department in satisfying its statutory obligations under Title XXIX. Although it is the LRA's responsibility to prepare a complete application to justify both the use of the EDC as the transfer method and the specific terms they offer, the Military Department should assist them with developing the application. A great deal of the information necessary for an application is readily available to the LRA through the community planning process and supported through existing DoD technical and financial resources. To the extent information that would assist in redevelopment planning is available from existing studies, it should be made available. In general, the process should be a cooperative effort in furtherance of the goal of the Military Department to rapidly transfer property and the desire of the LRA to receive the property for long-term job creation.

Beyond the standard planning information, LRAs should incorporate a business/operational plan into their overall base reuse planning. This effort will assist LRAs in identifying necessary implementation resources and establishing a community-based proposal for the Military Department's consideration. This

business/operational plan will form the basis for community negotiations on the purchase price for the property, Accordingly, the Military Departments should share market trends underpinning their appraisal as soon as they are available and the LRA should strive to include this data in its analysis.

Before an application is prepared, the LRA should meet with the Military Department, the BTC, and the OEA Project Manager in a pre-application workshop to discuss: property acquisition alternatives; the requirements of an EDC application; the timetable for Military Department actions; and the LRA's timetable and needs to ensure that an adequate planning effort is undertaken.

When should an application be made?

7.2.1 Timing of the EDC application

Before an EDC application can be submitted, the LRA must adopt a redevelopment plan (see Section 3.4.2, Contents of the redevelopment plan) that will be included in its submission to HUD as well as provided to the Military Department for consideration in its review under NEPA. The Military Department responsible for the property shall then establish a reasonable timeframe for submission of an EDC application. The timeframe should not extend past one year from the submission of the redevelopment plan or the closure date for the installation, whichever is earlier. These timeframes should be communicated to the LR4 in writing. If an application is not made within the timeframe established by the Military Department or the LRA no longer desires to apply for an EDC, disposal may proceed under alternative methods including a negotiated or public sale of the property. The LRA always has the option of acquiring property under the FPASA, and thus it may not be necessary to complete an application for an EDC within the stated timetables.

How much property should be included in an EDC application ?

7.2.2 Amount of property included in an EDC

The EDC should be used by LRAs to obtain large parcels of the base rather than individual buildings. The income received from some of the higher-value property should be used to offset the maintenance and marketing costs of the less desirable parcels. While the LRA is not permitted to select only high-value facilities for the EDC parcel, they will not be required to take more property than could be supported by the long-term redevelopment efforts. Generally, there should be only one EDC application per installation, so the size of the EDC parcel should be carefully selected. At the LRA's discretion, personal property maybe requested as soon as it is available for disposal through a separate EDC application.

What must an EDC application contain ?

7.2.3 Contents of the application

The application should explain why an EDC is necessary for economic redevelopment and job creation. The application does not need to be overly complex, nor does it require a great deal of new information. In most cases the information should have been gathered as part of the overall planning process. *Since this process was designed as a flexible tool to meet individual facts and circumstances, there is no requirement that all applications look the same. The Military Departments and the community should work together to agree on the types of information needed to properly evaluate an application.*

The application should contain the following elements:

- . A copy of the adopted redevelopment plan.
- A project narrative including the following:
 - A general description of property requested.
 - A description of the intended uses.
 - A description of the economic impact of closure on the local communities.
 - A description of the financial condition of the community and the prospects for redevelopment of the property.
 - A statement of how the EDC is consistent with the overall Redevelopment Plan.
- . A job generation schedule, including a description of how the EDC will contribute to short- and long-term job creation and economic redevelopment of the base and community. The projected number and type of new jobs it will assist in creating should be estimated.
- A business/operational plan for the EDC parcel. This plan presents a blueprint for LRA implementation of the redevelopment plan, including the financing, management, and municipal service requirements for reuse. The overall analysis will depict how the recognized obligations will be met along with the following:
 - A development timetable, phasing schedule, and cash-flow analysis.
 - A market and financial feasibility analysis describing the economic viability of the project, including an estimate of net proceeds over the projected development period, the proposed consideration and payment schedule to the Department of Defense, and the estimated fair market value of the property.
 - + A market analysis should explore the current availability and absorption of the type of property proposed in the EDC parcel and a projection of future demand for similar property. To ensure some connectivity between the business plan and the Military Department's appraisal efforts, the LRA's business planning activity should be scheduled so that it may incorporate market trend data from the appraisal.
 - ◆ See Table 7-1 for a potential format for a project pro-forma as a way of addressing this requirement. In this instance, the pro-forma reflects a predominately commercial development. Remember that each application is likely to be different and may not need to go into the same detail as the model provided.

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- A cost estimate and justification for infrastructure and other investments needed for the development of the EDC parcel. For example:
 - + The estimated costs for improvements and a description of the need for that level of investment should be offered. This could include a description of the alternatives explored and the cost/benefit analysis of that type of investment. For example, if the LRA plans on creating a new park as a centerpiece for an office complex, contrast the costs and benefits of creating a \$1 million park versus a \$10 million park.
- ◆ A description of the income that maybe generated from that investment. For example, if \$10 million was needed to expand the water and sewer system, estimate the income received from the new customers at the base that could pay for a portion of the new investment.

Developer Spreadsheet Pre-tax Cash Flow Analysis											
Symbols		YR1	YR2	YR3	YR4	YR5	YR.	YR.	YR.	YR.	YR15
REVENUES											
+ Gross Rent	+ G. RENT										
+ Other Income	+ O. INCOME										
+ Tenant Contribution	+ T. CONTB.										
= Gross Income or Gross Rent	= G. INCOME										
- Vacancy Contingency	- VAC										
_% Vat. Rate x Gross Income											
= Effective Gross Rent (or Gross Collections)	= EGR										
Operating Expenses											
Insurance (\$__p.s.f.)											
Maintenance & Structural Repairs (\$__p.s.f.)											
Management Fees											
Property Taxes (\$__p.s.f.)											
Misc. Operating Expenses											
Reserves											
- Total Operating Expenses	- OPR. EXP.										
= Net Operating Income	= NOI										
- Debt Service (Annual Principal & Interest)	- D/S										
- Debt Service	- D/S										
= Cash Flow Available for Distribution	= CF										
CASH-ON-CASH ROI											
Cash Flow Available for Distribution	CF	%	%	%	%	%	%	%	%	%	%
Original Equity Investment	EQ										

Table 7-1. Pro-Forma Developer Spreadsheet for Cash Flow Analysis

— Local investment and proposed financing strategies for the development.

- ◆ This is probably the most important part of the application because it provides the basis for the Military Department's determination as to the project's feasibility. The LRA should describe how it will finance the project; e.g., through taxes, bond financing or partnership with private sector interests. This may include a statement from bond counsel or potential financial investors of their interest in assisting the overall development. In instances where the business plan analysis results in marginal values, detailed information on the source of any public or third party funds should be provided.

Bond Financing

- **Ft. Devens, Mass.**—In January of 1994, the State of Massachusetts passed landmark legislation creating the Devens Enterprise Commission to guide the redevelopment of the former Ft. Devens. With this legislation, the State provided \$200 million in bonding capacity for the Massachusetts Government Land Bank to use to fund the redevelopment efforts.
- **NAS Glenview, Ill.**—Even before the base was closed, the Village of Glenview obtained the authority to issue \$60 million in bonds for the specific purpose of making infrastructure improvements to NAS Glenview. The repayment of the bonds will be derived from the increase in property taxes the Village will receive once the base is transferred and placed on the tax rolls.

- A statement describing why other Federal property transfer authorities—such as public or negotiated sales and public benefit transfers—cannot be used to accomplish the economic development and job creation goals.
- A statement including the amount and form of the proposed discounted consideration, a payment schedule, the general terms and conditions for the conveyance, and the projected date of conveyance. If a transfer is requested for less than the community's estimated value, an analysis justifying the discount shall be provided.
- . A statement of the LRA's legal authority to acquire and dispose of the property.

Additional information may be requested by the Military Departments to allow for a better evaluation of the application.

7.2.4 Valuation

A key to a successful EDC is a proper and *realistic* valuation of the property. This must be done in a cooperative fashion, with both the LRA and the Military Department using realistic market trends that are right for the local marketplace.

Title XXIX requires that the Secretary of the Military Departments determine the estimated fair market value of the property before conveying property through

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an EDC. The estimated fair market value should be expressed as a range of values based on the intended land uses outlined in the redevelopment plan.

The **Military** Department should begin its appraisal as soon as possible following submission of the final redevelopment plan, ensuring the effort is underway within six months from the final plan submission. A copy of the appraisal instructions or scope of work shall be provided to the LRA at the earliest possible time. Once the appraisal is underway, market trends shall be provided iteratively to ensure the community's analysis benefits from the effort. To ensure some connectivity between the business plan and appraisal efforts, OEA shall inform the Military Department when it has approved community planning assistance for a business plan. Similarly, LRA business **planning** activity should be scheduled so that it may incorporate market trend data from the appraisal in its analysis.

- **Market trends** — Market trends provide a linkage between the community's business plan and Military Department's appraisal. As such, both efforts should strive for the inclusion of similar data in their respective analyses.

When designing specific market trends, the following factors should be considered:

- Escalation and market absorption rates for the different types of land use in the local redevelopment plan
 - Base rental/sale income at the base year for types and classes of property and a rate of inflation
 - Cost of infrastructure improvements needed to meet State and local codes and meet market demands to arrive at the target rent/sale price
 - Maintenance costs before sale/lease
 - Applicable discount and capitalization rates
 - Developer's profits
- In most cases, because of the lack of comparable sales for properties the size and complexity of EDC transactions and the physical obsolescence of many military buildings, a standard real estate appraisal using the comparable or cost approach to value should not be used. The income approach to valuation will probably be the preferred approach. The elements of the income approach, projecting net operating income based on market trends and selecting a capitalization rate, can be used as part of the process in determining value for an EDC, and will normally be a central element in the business/operational plan. Fair market value should be estimated in terms of its present value, not its value after development. Therefore, the valuation process should identify current and projected market rents for the uses defined in the Redevelopment Plan or create rental income trends to be used in determining the estimated fair market value. The capitalization rate chosen should also be a function of rates of return in the present-day marketplace

adjusted for risk. The estimation of fair market value then becomes a function of the economic value, derived from the projected net operating income and the capitalization rate using present-day market and absorption trends. The estimated fair market value then is the economic value minus the cost to cure the physical and infrastructure obsolescence of the base to make the space and land usable in present-day market conditions.

Example: Income Approach to Valuation of Property

GROSS ANNUAL REVENUE	
Gross Building Area	600,000 sq. ft.
Net Leasable Area	600,000 sq. ft. X 85% = 510,000 sq. ft.
Annual Rent/Sq. Ft.	\$7.00
Annual Income at 100% Occupancy	\$3,570,000
Vacancy Factor (10%)	<u>-357,000</u>
Gross Annual Revenue	\$3,213,000
Total Operating Expenses	<u>-1,120,000</u>
Net Operating Income	\$2,093,000
ECONOMIC VALUE	
Capitalization Rate	15%
Net Operating Income	<u>\$2,093,000</u>
Economic Value	\$13,953,333
CAPITAL INVESTMENTS (cost of cure)	
Building Renovation (@ \$9.00/sq. ft.)	\$5,400,000
Demolition	600,000
Infrastructure Repair/Replacement	<u>6,200,000</u>
Total Capital Investment	\$12,200,000
ESTIMATED FAIR MARKET VALUE	
Economic Value	\$13,953,333
Total Capital Investment	<u>-12,200,000</u>
Estimated Fair Market Value	\$1,753,333

7.3 APPLICATION REVIEW AND APPROVAL

7.3.1 Authority to approve an application

After receipt of an application for an EDC, the Secretary of the Military Department will determine whether an EDC is consistent with the criteria stated *in the* regulation and is appropriate to spur economic redevelopment and job creation. The terms and conditions proposed will be examined to determine if the offer is fair and reasonable. The Military Department may also consider information independent of the application, such as views of other Federal Agencies, appraisals, caretaker costs, and other relevant information.

Who will approve or deny an EDC application ?

Upon receipt of an application, the Secretary should establish an estimated time period within which the application will be reviewed and inform the LRA of the time period.

**What criteria are
used in evaluating
an EDC application?**

7.3.2 Criteria used to evaluate an application

The following criteria and factors will be used, as appropriate, to evaluate the proposed terms and conditions of the EDC, including price, time of payment, and other relevant methods of compensation to the Federal Government. *These factors are not a checklist and therefore there is no requirement that all elements be met. Instead, these factors are meant to serve as guidance for decision makers.*

- . Adverse economic impact of closure on the region and potential for recovery after an EDC.
 - The greater the impact of closure, the greater the need for assistance.
- . Extent of short- and long-term job generation,
 - An EDC might create 1,000 construction jobs (short-term) and 3,000 permanent jobs in the community. An EDC that only produces short-term job creation is not acceptable.
- Consistency with the overall redevelopment plan.
- Financial feasibility of the development, including market analysis and the need and extent of proposed infrastructure improvements.
- . Extent of State and local investment and level of risk incurred, as well as the ability of the LRA to implement the plan.
 - The more the community is investing in the overall development, the more they are contributing to the overall value. The increased risk by the community should be viewed favorably.
 - Approved zoning demonstrates an important step toward successful implementation of the plan and should be viewed favorably.
- Economic benefit to the Federal Government, including protection and maintenance cost savings and anticipated consideration from the transaction.
 - Saving of protection and maintenance expenses can be more valuable to the Military Department than a (hypothetical) high sales price.
- . Incorporation of other Federal Agency interests and concerns, and applicability of and conflicts with other Federal surplus property disposal authorities.
- Relationship to the Military Department disposal plan for the installation.
 - If the LRA is not requesting the entire base through an EDC and/or public benefit transfers, the Military Department should explore its ability to dispose of the remaining parcels.
- Compliance with applicable Federal, State, and local laws and regulations.

7.3.3 Approach for application review

- The LRA's application will be the starting point for review of the proposed EDC. However, the Military Departments and the LRA are encouraged to work together before an application is submitted in order to ensure a quick review and approval process. This review and approval process should be fairly simple if both parties are open throughout the negotiations.
- The Military Department may request additional information from the LRA and may use additional information. Any additional information used in evaluating the application will be shared with the LRA unless doing so would compromise national security.
- The Military Department should review information contained in the application and ask the LRA for appropriate verification if needed for proper evaluation.
- The Military Department will evaluate the proposed terms and conditions of the EDC, including price, time of payment, and type of financing. If the proposal is not deemed to be acceptable, the Military Department should propose options for the LRA to consider.

What will be the Service's approach in reviewing the application ?

In the event that an application is not approved and negotiations on an acceptable application are not concluded, the Secretary of the Military Department shall state the reasons for disapproval in writing.

An approved EDC application will be included in leasing documentation in the event that the LRA will obtain a lease in furtherance of conveyance (see Chapter 5, Leasing for Reuse).

7.4 CONSIDERATION

7.4.1 Guidelines for determining terms and conditions

In negotiating the terms and conditions of consideration with the LRA, the Secretary of the Military Department must determine that a fair and reasonable compensation to the Federal Government will be realized from the EDC. The individual circumstances of each community and each base mean that the amount and type of consideration may vary from base to base. The regulations implementing EDCS give great flexibility to the Military Department to negotiate with the LRA and arrive at an appropriate arrangement. A base's value may be high or low, depending on its particular circumstances. The range of the estimated present fair market value may be broad or narrow. The Department of Defense is required by Title XXIX of the National Defense Authorization Act for FY 1994 to obtain consideration within the estimated range of present fair market value or to justify why such consideration was not realized.

How are the terms and conditions for payment considered?

As stated above, the EDC application must propose general terms and conditions of the conveyance, as well as the amount and type of the consideration, a payment schedule, and projected date of conveyance. After reviewing the application, the Military Department has authority to enter into one of two types of agreements:

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- Consideration within the estimated range of present fair market value, as determined by the Secretary of the Military Department. The Military Department can be flexible about the terms and conditions of payment, and can provide financing on the property. The payment can be in cash or in kind, and can be paid at time of transferor at a time in the future. The Military Departments have the flexibility to enter into agreements that specify the form, amount and timing of consideration and ensure that consideration is within the estimated range of fair market value at the time of application. Such methods of payment could include **participation** in the gross or net cash flow, deferred or triggered payments, mortgages, or other financing arrangements. For examples of financing options, see” Section 7.4.3.
- Consideration below the estimated range of fair market value, where proper justification is provided. If the Secretary of the Military Department finds a discount necessary to foster local economic redevelopment and job creation, the amount of consideration can be below the estimated range of fair market value. Again, the terms and conditions of payment maybe flexible to accommodate reasonable redevelopment requirements and will be negotiated between the Military Department and the LRA.

The terms and conditions should recognize the time value of money, and should offer incentives for early payment. If the consideration calls for payment at some time in the future and accrual and payment of interest is not included in the terms, it will be considered a discounted conveyance and proper justification must be given.

7.4.2 Justification for discount

What justification is necessary to receive a discounted EDC?

- Where property is transferred under an EDC at an amount less than the estimated range of fair market value, the Military Department shall prepare a written explanation of why the consideration was less than the estimated range of present fair market value.
- The LRA is given an opportunity to make its case for a discount in its application. The most important consideration for a discount from estimated fair market value is job creation: an LRA must demonstrate that the discount is needed to spur job creation. The LRA must show that it will immediately put **the** property to productive use and, as a result, cannot afford to pay the same price as a speculator would who would hold the property until the market demand increased.
- Proper justification shall be based upon the findings in the business/operational plan contained in the EDC application. Development economics, including absorption schedules and legitimate infrastructure costs, would provide a basis for such a discount by demonstrating that without such discount, the development would not occur at **this time**. **An** inability to pay at time of conveyance or to obtain financing would not be a proper justification since payment can be deferred and terms and conditions can be negotiated.

7.4.3 Rural bases

Any EDC approved by the Secretary of the Military Department for a base that is not within a Metropolitan Statistical Area (MSA, as defined by the Office of Management and Budget) shall be conveyed at no cost if the Secretary concerned determines that the base closure will have a substantial *adverse impact* on the economy of the **communities** in the vicinity of the installation@ on the prospect for economic recovery. An LRA may be able to reduce the information requirements for its rural application following consultation with the Military Department. At a minimum, such an application must still include a job generation schedule and a limited business/operational plan. In bases located outside an MSA:

- A closure will be determined to have a substantial *adverse* impact on the economy of the communities in the vicinity of the installation if OEA has made a determination under 10 U.S.C. 2391 that the closure is likely to have a direct and significant adverse consequence on the community. The OEA Project Manager can provide information about whether such a determination has been made. Absent an OEA determination, a community will not be eligible for a rural, no-cost EDC.
- The Military Department should work closely with the LRA to learn of the local conditions affecting reuse and identify local economic indicators that would substantiate a finding that the base closure will have a “substantial adverse impact on the prospect of economic recovery.” The LRA will provide such information in its application to assist the Military Department with its determination.

7.4.4 Financing

The Military Department may negotiate any appropriate mechanism with the LRA that provides fair and reasonable compensation to the Federal Government. The Secretary of the Military Department will review the compensation arrangement to ensure that there is a reasonable prospect of payment.

What financing options are available for an EDC?

CASH PAYMENT AT TIME OF TRANSFER

Cash payment at the time of transfer will generally happen for one of the following reasons:

- The LRA finds a major or single user willing to make an initial cash payment to the LRA.
- The LRA has a source of dollars with no repayment or with payment terms more favorable to the project than the terms of the Military Department.
- There is the opportunity for significant up-side potential in the redevelopment of the facility.

DEFERRED PAYMENT

- Note. Unless the property is being transferred at no cost or for a cash payment at the time of transfer, there will be a Note between the Military Department and the LRA. A Note is a promise to pay, at a future date, a specific amount with specific terms. For example, a Note between a

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Military Department and the LRA could be for a purchase price of \$4 million for the property with no payment due or interest accruing until the fifth year after the sale, at which time the loan for the purchase price would begin to amortize over a 20-year term at seven percent interest per annum. The loan could be structured to require payment on a regular schedule for the next 10 years, with a balloon payment at the end of the term for the remaining unpaid balance of the loan.

The terms of the Note are negotiated between the parties based primarily on the economics of the transaction and the capacity of the buyer to pay the seller from project cash flow.

- ◆ **Deferred payment (in cash or in kind).** A deferred payment is a future payment that is normally defined in a Note between the LRA and the Military Department. The Note will normally be secured by a mortgage, deed of trust, or other acceptable security arrangement on the property being financed. The two examples of completed EDCS described in Section 7.5 demonstrate the range of possible deferred-payment arrangements. At Norton Air Force Base, the payment is dependent on gross income or sale, with payment terms specified for specific parcels.

Example: Balloon Note	
Purchase Price	\$4,000,000
Payments, Years 1-5	None
Payments, Years 6-15	\$377,571 yearly
Balloon payment due Year 15	2,651,905
<i>Payment based upon 20-year amortization, 7% note</i>	<i>\$377,571</i>
Principal reduction, Years 1-10	\$1,346,095
<i>Remaining balance</i>	<i>\$2,651,905</i>

- **Subordinated notes.** Holders of subordinated notes are in a junior position to another lender with regard to the assets being financed. Subordinated notes are also known as Second Mortgages and Junior Lienholders. Being in a subordinated position means that in the event that a foreclosure occurs, the junior lienholder will be paid only the amount available after the senior lienholder has been paid. Payment of a note or mortgage can also be subordinated and the position of the lien can be moved to encourage additional investment. This is often termed a “soft” second mortgage and could be used as an effective way to encourage private investment to make the necessary infrastructure investments needed at many closing bases. The Military Departments should be willing to accept a subordinated position if doing so will help redevelopment.

PARTICIPATION IN THE CASH FLOW AND PARTICIPATION IN RESIDUALS AND BENEFITS OF SYNDICATION

- Partnership Model. When the Military Department receives its payment from cash flow, the Department functions like a partner with the LRA in the ownership of the property. Like any owner of real estate, the Department would receive its return from cash flow. No specific payment or return would be guaranteed to the Department. This is the highest-risk involvement for the Department, but it also has the highest potential for return because the Department shares in the up-side potential of the development.
- Net Profit Model. When the Military Department receives payment from net profits, it receives payment from the residuals of sales or refinancing. The net profits of sales or refinance are typically called “net proceeds.” Net proceeds are defined as all proceeds from a sale less repayment of debt not being assumed by the buyer; normal costs associated with sale; and pre-agreed-upon expenses or returns to the LRA. In terms of refinancing, net proceeds represent the cash received from the issuance of new debt and the payment of debt being refinanced.
- Syndication Model. Depending on the real estate market, current tax laws, and Federal tax credits, the LRA may, at a point after the conveyance, create a Limited Partnership for the purpose of generating cash for the development with no financial repayment schedule. A Limited Partnership is a partnership that consists of a General Partner—usually the developer, and in this case, the LRA—and Limited Partners who invest for return (cash flow) and tax benefits. The partnership is managed by the General Partners, and the Limited Partners are passive investors.
 - ◆ An LRA with a base that contains many old certified historic buildings may consider the formation of or transfer to a series of individual Limited Partnerships as a means of generating cash for investment in the renovation or as repayment to the Military Department.

7.5 CASE STUDIES OF TWO SUCCESSFUL EDCS

The following are case studies of how two successful EDCS were completed. They are provided by way of example, and in no way should they be viewed as **the only** appropriate terms for an EDC. Remember, there is no single way to structure an EDC or a cookie-cutter answer that applies in all cases.

Are there examples of successful uses of an EDC?

7.5.1 Sacramento Army Depot

Sacramento Army Depot (SAAD) was announced for closure in 1991. Initially, the reuse planning process was leading toward a reuse scenario in which a majority of the property would be retained by the Department of Defense or conveyed at no cost for public benefit purposes. These uses would bring no revenue to the Army and in most cases would not contribute new jobs to the community. In November 1994 the City of Sacramento, Calif., the recognized LRA, submitted to the Army an application for an EDC of 400 acres of SAAD, following guidelines from the October 1994 final rule. Under the EDC, the City

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will lease 1.8 million square feet of the site to Packard Bell Electronics, which is projected to employ approximately 3,000 persons with an annual payroll of \$60-80 million. The secondary impact of Packard Bell’s activities is expected to result in an additional 2,000-2,500 jobs.

The purchase price of \$5 million is based on estimates of the fair market value of the property, which ranged from \$4.2 million to \$6.2 million. In addition to the payment to the Army, the City will contribute \$1.4 million for on-site infrastructure upgrades and \$2.4 million for off-site improvements. Based on terms of a lease-purchase agreement negotiated between the LR4 and Packard Bell Electronics, \$17 million in building improvements will be financed by loans guaranteed by the City of Sacramento, with Packard Bell responsible for repaying those loans over the initial years of site occupancy. Packard Bell will pay a rental rate above the estimated fair market value, because the State of California passed special legislation allowing SAAD tenants to receive State tax credits that offset the higher occupancy costs. At Year 10, Packard Bell has an option to buy the property they are occupying, which has now increased in value because of improvement loans guaranteed by the LRA. The LRA has based their \$6.8 million second trust deed offer at Year 10 on the revenue expected from Packard Bell’s purchase options.

Terms of the Sacramento Army Depot EDC	
Price:	\$5 million
Discount:	3% per annum financing
Financing:	
•Duration:	10 years
•Principal Payments:	Lump-sum payment of \$6.8 million in Year 10
•Security:	
-Subordination:	Army holds second-trust deed
-Partial Releases:	Second trust may be paid early if tenant exercises purchase option before Year 10

Utility **systems** and personal property are being conveyed to the City along with the real property. Conveyance of the utility systems confers responsibility to the City for their improvement or transfer **to** utility companies while minimizing the Army’s caretaker requirements. The personal property items generally fall **into three** categories: furniture, computer equipment, and support equipment. The furniture consists primarily of office furnishings that make the office areas useful, and that were more cost-effective for the Army to transfer in place. Computers were somewhat outdated with only nominal market value, but may be useful for small companies or training. Support equipment will be used by the LRA to maintain common areas and thus the Army will not need to maintain a caretaker workforce.

7.5.2 Norton Air Force Base

Norton Air Force Base, located in San Bernardino, Calif., was announced for closure in 1988. The Inland Valley Development Authority (IVDA), the recognized LRA, requested approximately 580 acres at Norton AFB under an EDC. This property comprises the vast majority of the remaining Federal

property at Norton AFB-the airfield and associated property were disposed of as part of a public airport conveyance on January 19, 1994.

The IVDA provided a redevelopment plan with the potential for the creation of 1,000 jobs in the near term. The first interim final rules for EDCS, issued in April 1994, were used in evaluating the proposal. Based on the Air Force's evaluation, a Secretarial determination was issued to support the application. The Disposal Record of Decision was supplemented to reflect the EDC.

The purchase price essentially reflects the estimated fair market value as determined by an appraisal. The duration of financing (15 years) was initially adopted from the terms of the EDC envisioned in the April 1994 interim final rule and, although no particular duration is mandated by the latest version of the rule, the period was acceptable to the IVDA and the Air Force. The terms of payment were also based on the April 1994 EDC rule, which provided for a 60%/40% split of the *net* profits. However, because it was perceived that the accounting system required to verify proper application of expenses would be too burdensome, the parties ultimately agreed to a split of gross rents. Two additional terms were included to provide further assistance to redevelopment efforts: the Air Force agreed to subordinate its security interest to commercial construction loans and established a mechanism for the IVDA to obtain partial releases of property from the purchase-money lien that would encumber the property. In addition, as directed by the EDC rules, the standard excess profits covenant was incorporated into the transaction. Since this covenant has the potential to stifle property sales, its duration was limited to three years, the regulatory standard and perceived minimum.

Terms of the Norton Air Force Base EDC	
Price:	\$52 million
Discount:	0% financing
Financing:	
• Duration:	15 years
• Principal Payments:	40% of gross rents for 15 years with a balloon payment of any remaining debt due at the end of the 15th year (plus incremental payments of 100% of the proceeds <i>from</i> the sales of the property)
• Security:	Debt to be evidenced by a Promissory Note and secured by a purchase money Deed of Trust
-Subordination:	First Lien to be subordinated to construction loans only with payoff of Air Force interest with take-out or permanent financing
-Partial Releases:	Partial reconveyances (free of lien) for payment of an agreed release price or net sales price, whichever is greater

These terms were found to be consistent with the intent of the EDC. In general, they enabled the IVDA to obtain the property at no initial consideration and with payment obligations tied directly to the success of their efforts. Furthermore, assuming a successful redevelopment effort, the terms encourage the IVDA to "buy out" the Air Force's interest as soon as economically feasible. Payments to

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the Air Force of 40 percent of gross rents **will** likely exceed the debt service **payments** required if the property were financed through more conventional means, which will make conventional financing attractive when a steady tenant base has been established. Likewise, agreeing to subordinate only to construction loans and requiring a buy-out when take-out financing is obtained should result in incremental, but steady, partial **reconveyances**. All of which should contribute to the Air Force's receiving the purchase price before the 15th year.

Five documents are required to consummate the transaction: a contract (purchase and sale agreement); promissory note; deed of trust; **quitclaim** deed; and long-term lease in furtherance of conveyance. This array is necessary since most of the property is undergoing **environmental remediation** and Section 120 of the Comprehensive Environmental Response, Compensation, and Liability Act precludes immediate deed transfer. The contract provides that the IVDA must take full ownership when the Air Force can make the necessary covenants, but that the IVDA will enter into immediate possession under the long-term lease. When the Air Force is able to transfer by deed, the **quitclaim** deed and deed of trust will also be executed.

The long-term lease in furtherance of conveyance is similar to that used in other public benefit conveyance transactions. It differs to the extent necessary to make it consistent with the larger transaction, and includes a consideration (rents) provision that mirrors the 60%/40% split indicated **in** the contract and provides that all rents will be used to retire the debt evidenced by the Promissory Note. From a payment perspective the transition from lease to deed should appear seamless. And, the IVDA is not prejudiced by the Air Force's inability to immediately transfer the property by deed.